

**Letter of Findings Numbers: 08-0274 and 07-0553  
Corporate and Individual Income Tax  
For the Tax Years 2003, 2004, and 2005**

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**ISSUES**

**I. Adjusted Gross Income Tax–Business Expense Deductions.**

**Authority:** IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-8.1-5-1; [45 IAC 3.1-1-66](#); 26 USCS § 162; 26 USCS § 167; 26 USCS § 183; *Bower v. Comm'r*, T.C. Memo 1990-16 (1990); *Gill v. Comm.*, T.C. Memo 1994-92 (1994); *Rodgers Dairy v. Comm'r*, 14 T.C. 66 (1950); *Hopkins v. Comm'r*, T.C. Memo 2005-49 (2005).

Taxpayer protests the disallowance of certain business expense deductions.

**II. Tax Administration–Negligence Penalty.**

**Authority:** IC § 6-8.1-10-2.1; [45 IAC 15-11-2\(b\)](#); [45 IAC 15-11-2\(c\)](#).

Taxpayer protests the imposition of a ten-percent negligence penalty.

**STATEMENT OF FACTS**

During the audit years in question, Taxpayer was the sole shareholder of an Indiana subchapter S corporation ("S" Corporation). "S" Corporation offers a range of services related to all phases of commercial and private aircraft operations including inspecting, appraising, and repossessing aircraft and aircraft parts, as well as consulting, auditing, and expert testimony services. The Indiana Department of Revenue ("Department") conducted an income tax audit of the "S" Corporation for the years 2003, 2004, and 2005, along with a related investigation of Taxpayer's income tax. The Department's Audit Summary (Control No. 364057-04) and Investigation Summary (Control No. 306940-00) jointly found that expenses, losses and depreciation amounts related to business equipment, office and office addition expenses, luxury cars, leasehold improvement expenses, and a horse farm had been improperly deducted as business expenses. As a result, the Department assessed additional income tax, interest, and penalty against Taxpayer. Taxpayer and the "S" Corporation protested the proposed adjustments. Subsequent to Taxpayer's and the "S" Corporation's (hereinafter referred to as "Taxpayer") protests, Taxpayer and the Department agreed to certain additional deductions including some of the protested business equipment and the luxury cars. An administrative hearing was held on the remaining protest items, during which Taxpayer submitted additional information. This joint Letter of Findings results. Additional facts will be provided as necessary.

**I. Adjusted Gross Income Tax–Business Expense Deductions.**

**DISCUSSION**

Adjusted gross income tax is imposed on individuals by IC § 6-3-2-1. Adjusted gross income tax is imposed on shareholders of S corporations as provided by [45 IAC 3.1-1-66](#) which states:

Corporations electing Subchapter S status under Internal Revenue Code §1372 and which comply with the withholding requirements of [IC 6-3-4-13](#) are exempt from adjusted gross and supplemental net income tax on all income except capital gains subject to tax under Internal Revenue Code §1378. This exemption is effective until the corporation's shareholders terminate the election with the Internal Revenue Service or until the corporation engages in transactions which disqualify it from Subchapter S status. A complete or partial corporate liquidation or the intent to dissolve will not in itself terminate the election.

Subchapter S corporation shareholders are taxed on their distributive shares of income at the individual income tax rate. The character of the income (as capital gains or ordinary income) also passes through to the shareholders.

Although Subchapter S corporations are generally not subject to adjusted gross income tax, they are subject to use tax and intangibles tax, and must report and pay such tax at the time the annual return is filed.

Subchapter S corporations must also withhold adjusted gross income tax on any nonresident shareholder's share of corporate income.

Since Taxpayer was the sole shareholder of the "S" Corporation during the years in question, income from the business transfers to Taxpayer.

To compute a corporation's Indiana adjusted gross income tax, a taxpayer begins with its federal adjusted gross income and makes certain adjustments. IC § 6-3-1-3.5. Two such adjustments in determining federal adjusted gross income are applicable to the case at hand. One adjustment is found in 26 USCS § 167, which provides that, in general:

There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)–

- (1) of property used in the trade or business, or
- (2) of property held for the production of income.

The other adjustment applicable to the case at hand is found in 26 USCS § 162, which provides that, in general:

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business....

"Ordinary" refers to expenses that "should have a reasonably proximate relation to the operation of [a taxpayer's] trade or business." *Bower v. Comm.*, T.C. Memo 1990-16 (1990). To qualify as "necessary" expenses, the expenses "must be 'appropriate' or 'helpful' to the taxpayer's trade or business." *Id.* Additionally, any "taxpayer who engages in activities for which advertising or promotional expenses are claimed must have reasonably intended that the activities advertise his business." *Id.*

When "deciding whether an expense is ordinary and necessary within the meaning of section 162, courts generally have focused on the existence of a reasonably proximate relationship between the expense and the taxpayer's business and the primary motive or purpose for incurring it." *Gill v. Comm'r*, T.C. Memo 1994-92 (1994). For example, a taxpayer who claims as an advertising expense deduction the exhibiting of show animals must show that it "honestly intended to acquire and use the animals for advertising purposes," and that it "continued to use them for that purpose." *Rodgers Dairy v. Comm'r*, 14 T.C. 66 (1950). A general statement that "expenses were incurred in pursuit of a trade or business is not sufficient to establish that the expenses had a direct relationship to any such trade or business." *Hopkins v. Comm'r*, T.C. Memo 2005-49 (2005).

One test to ascertain the intent of the taxpayer is to consider the "reasonableness or unreasonableness of the expenditures in relation to the business. . . ." *Rodgers Dairy*. "Even if an expense is ordinary and necessary, it is deductible under section 162 only to the extent it is reasonable in amount. *Gill*. When "an expenditure is primarily associated with profit-motivated purposes, and personal benefit can be said to be distinctly secondary and incidental, it may be deducted under section 162." *Gill*. If, however, "an expenditure is primarily motivated by personal considerations, no deduction for it will be allowed." *Gill*.

*A. Disallowance of Business Equipment Expense Deductions, Office and Office Addition Expense Deductions, and Leasehold Improvement Expense Deductions.*

After the audit and investigation, the Department disallowed expenses and depreciation relating to various luxury cars (identified on page 7 and 8 of the Department's Investigation Summary Control No. 306940-00) as well as deductions for the following items (identified on Page 9 of the same Investigation Summary), which Taxpayer protested:

1. Generator;
2. 575 2 trak diesel gator;
3. 1998 Gator 4x4;
4. Boroscope;
5. 1992 case forklift;
6. Toolcat 5600;
7. Toolcat 5600;
8. T-c trailer;
9. Office addition;
10. Office in home; and
11. Leasehold improvements.

Subsequent to the protest and prior to the hearing, the Department and Taxpayer agreed that the luxury cars and items 4, 5, 6, 7, and 8 were deductible. Because of the agreement with the Department, this Letter makes no legal determinations as to the validity of the business expense deductions relating to these items. Taxpayer is on notice that subsequent treatment by the Department may differ. The remaining items are still under protest. Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

As part of its protest, Taxpayer supplied the Department with documentary evidence, including photographs of several of the items, and asserts that all of the above-referenced items pertain to its aviation business and not its horse ranch. Accordingly, Taxpayer argues that the deductions taken for the above-referenced items should be allowed as expenses of the business.

However, excluding the photographs relating to items 9, 10, and 11, the photographs do not provide sufficient evidence for the Department to determine that they are used, either exclusively or in part, by Taxpayer's aviation business. None of the items in question are identifiable as belonging to the aviation business and not to that of the horse ranch. For example, the photographs of the generator certainly identify it as a generator. However, the photographs do not identify the generator's specific location relative to the business, nor do the photographs clarify the use of the generator relative to the business.

As for the office, office addition, and leasehold improvements (items 9, 10, and 11), the photographs presumably show various locations inside Taxpayer's residence, where its office is located. The photographs show what appear to be the effects of the remodeling of and/or the improvements made to Taxpayer's business

office. As a whole, the photographs tend to support Taxpayer's claim that these expenses are related to its aviation business and are exempt.

Therefore, of the remaining protested items, items 9, 10, and 11 are deductible under 26 USCS § 167, and items 1, 2, and 3 are not deductible.

*B. Disallowance of Horse Ranch Expense Deductions.*

Taxpayer owns a horse ranch, expenses for which Taxpayer deducted from its income on the basis that such expenses were "ordinary and necessary" advertising and promotional expenses related to its aviation business. The Department denied the deductions relating to Taxpayer's horse ranch.

Taxpayer argues that the horse ranch expenses "are deductible in full under IRC 162 as ordinary and necessary business expenses of the Corporation as those expenses are directly related to the advertising and promotion of the Corporation." Taxpayer states that the expenses are "ordinary and necessary." Taxpayer's arguments relate to the following factors: (1) the reasonableness of the expenses, (2) the promotional and advertising activities engaged in with the horses, and (3) the intent of Taxpayer.

Taxpayer maintains that the expenses related to the horse ranch were reasonable in relation to expected benefits. Taxpayer's assertion of the reasonableness of its expenses is primarily comprised of three key claims: Taxpayer's clientele are influential and successful, and, presumably, require personal attention; Taxpayer's use of the horse ranch as a means for promoting and advertising its aviation business resulted in increased revenue and more clients for Taxpayer; and Taxpayer's use of the horse ranch for promoting and advertising its aviation business was more successful than more conventional print advertising. In its letter dated May 29, 2008, Taxpayer explains the "elaborate" and "unconventional" promotion and advertising regarding the horse ranch. Taxpayer states:

[T]he Corporation's customers include very large and lucrative companies and key executives of the aviation industry. The reward for both obtaining and maintaining customers is huge in terms of potential lucrative contracts. Thus, the promotion and advertising of the Corporation is necessarily elaborate.

Taxpayer's "target audience is primarily individuals who charter aircraft and individuals owning or wishing to own an aircraft that are in need of acquisition assistance and/or long term management." (Taxpayer's letter dated June 17, 2008). Taxpayer states that its expenses related to the horse ranch were reasonable because in order to reach its select clientele, Taxpayer needed to institute elaborate measures.

In its letter dated October 10, 2007, Taxpayer explains:

Taxpayer was the sole owner of a large business that succeeds in part based upon establishing a close relationship with each and every big-time customer. The reward for obtaining a customer is huge in terms of potential lucrative contracts. Thus, the entertainment and promotion of the Company is necessarily elaborate. In the instant case, Taxpayer through her Company, utilized exotic automobiles and her horse farm to entice corporate executives to visit the Company and discuss lucrative contracts. Many of these visits lead [sic] to the signing of huge contracts that translated to a larger revenue stream to the Company. Support for the client's connection to the... horse farm to effectuate business was graphically provided to the examining agent through correspondence and photographs. Clearly, such expenditures should be deemed to be ordinary and necessary... the horses are provided for use by the Corporation's customers, their friends and their family and the Corporation also conducts business meetings where the horses are kept, in hopes to obtain new clients, conduct business, and to maintain and strengthen relationships and bonds with clients.

Taxpayer maintains that it receives "more than three visitors per week who visit the ranch and are given access to the horses," but has not substantiated that claim sufficiently. The Department also is without information as to the number of horses participating in events at the ranch. Whether one or two horses participated or every horse in the stable participated is a valuable distinction when considering the deductibility of the expenses of the entire horse ranch. Without the above information, the Department is unable to assess the reasonableness or unreasonableness of Taxpayer's expenditures related to promotions and advertising directed at Taxpayer's clients.

Taxpayer also argues that such measures were reasonable in relation to the expected benefits because they led to increased numbers of clients. In support of its position, Taxpayer relies on *Gill*. In *Gill*, the court sustained a corporation's advertising expenses related to a particular race car where the expenses were reasonable "in relation to the benefits reasonably expected to be obtained in return."

Taxpayer concludes:

The taxpayer advertised the corporate name on the side of the race cars that it raced at various tracks which in turn generated publicity for the corporation. The taxpayer in that case indicated that it sought to distinguish itself from competitors by developing a unique image in its industry. This is the same idea that [Taxpayer] had in using the horses to advertise the Corporation... The court in *Gill* also found it significant that 'the race cars sponsored by (taxpayer) were occasionally mentioned by the (corporation's) customers in their correspondence with (Corporation)[sic]. . . indicating that the race car sponsorship aided in producing favorable publicity and a distinctive image for (Corporation)[sic]. (Taxpayer's letter dated May 29, 2008).

However, significant key facts found by the court in *Gill* differ from those present in Taxpayer's protest. Where the expenses were excessive compared to other race cars on which the corporation advertised, the court reduced

the allowable deductions to a reasonable amount. The court wrote:

The expenses incurred by Quilting to sponsor Pringle's race cars contrast markedly with the [expenses] incurred by Quilting with respect to Gill's race car activities... We conclude that the expenses incurred by Quilting to sponsor Gill's race cars were excessive in relation to the benefits reasonably expected to be obtained in return.

Taxpayer offers no evidence, other than its say-so, that its claimed advertising expenses are reasonable.

Additionally, in *Gill* the taxpayer's name was "prominently displayed in large letters on both sides of the race cars sponsored by [the taxpayer]." Unlike any of Taxpayer's events, national broadcast media covered some of the events in *Gill*. Moreover, the taxpayer in *Gill* displayed posters of its race cars at "trade shows where it marketed its products" which drew in people who would not have otherwise necessarily been interested in the business. Also, in *Gill*, a "significant publication" in the taxpayer's industry featured an article based on the taxpayer's "racing and business activities." Therefore, taxpayer's race car activities in *Gill* resulted in significant advertising for its core business.

To the contrary, Taxpayer has provided the Department with a list of clients in 2002 and 2006. Taxpayer states that the two lists show a "significant increase in [Taxpayer's] client base." However, the lists Taxpayer has provided to the Department reflect a decrease—not increase—in Taxpayer's client base. According to the lists, Taxpayer had 61 clients in 2002, but only 52 clients in 2006.

Aside from the claimed impact on the number of its clients, Taxpayer also states that the horse ranch had a positive impact on Taxpayer's revenue. Taxpayer cites to *Bower*, which held that deductions taken by a taxpayer for sponsorship of a basketball team were appropriate advertising expense deductions. The court in *Bower* wrote:

Petitioner's business has benefited from the successful Hustlers basketball team's local and regional newspaper, television, and radio coverage. The team's publicity provided petitioner with good local and regional advertisement of his name to rental and commodity trading customers at a relatively low cost...

Petitioner has also established a proximate relationship between the basketball team's expenditures and his operation of Bower Housing and his business as a commodity broker working for Conti. As previously noted, petitioner's commissions earned increased while working with Conti....

Taxpayer has provided a simple "breakdown" of "revenue" from 2001 to 2006, showing an increase from \$3,043,329 in 2001 to \$9,221,222 in 2006, in support of its contention that its use of the horse ranch is somehow connected to the increase in its revenue. However, tax returns submitted by Taxpayer for the same years indicate that the costs of goods sold by Taxpayer increased from \$2,230,985 in 2001 to \$6,222,931 in 2006. So while it is clear that Taxpayer's revenue increased from 2001 to 2006, it remains unclear as to the reason(s) why. Aside from testimonial letters written by some of Taxpayer's clients, Taxpayer has not provided any evidence supporting a connection between the increase in revenue and the operation of the horse ranch. Without further evidence, the Department cannot ascertain the contributing factors of Taxpayer's increased revenue. More particularly, the Department cannot identify any additional sales or clients that may have contributed to Taxpayer's increased revenue.

In addition to revenue and client base growth attributed to use of the horse ranch, Taxpayer states as part of its reasonableness argument that the use of its horse ranch as advertising has been "more successful" than more conventional print forms of advertising. (Letter from Taxpayer dated June 17, 2008). While Taxpayer's revenue did increase from 2001 to 2006, Taxpayer has not provided the Department with any evidence of how much Taxpayer spent on print or other advertising prior to discontinuing its use. Therefore, the Department is without sufficient information as to determine the reasonableness of Taxpayer's use of the horse ranch for promotion and advertising its aviation business.

As for specific activities that advertise and promote Taxpayer's business, Taxpayer states that "the horses advertise the Corporation by participating in city parades and other events where the Corporate logo may appear on a horse's blanket or on a carriages [sic] the horse is pulling." Taxpayer specifically referenced a parade in its locale, which, according to the United States Census Bureau, is a small to medium sized Indiana community of approximately 30,000 residents. Parades in such a community presumably attract only local interest and media coverage. Taxpayer refers to other parades, but does not identify them. Taxpayer's pictures of the parades, which do not include a date or time, do not show Taxpayer's logo appearing on a horse's blanket or any other item easily visible by the public at such events. The advertising and/or promotional value of these activities is questionable given Taxpayer's own description of an exclusive clientele.

In addition to the parades listed above, Taxpayer also states that on a weekly basis the horse ranch features prominently when its clients come to Taxpayer's premises. Taxpayer explains:

[T]he horses are used as a method of enticing the Corporation's customers, family and friends to visit the Corporation, which is where the horses are kept, in hopes to obtain new clients, conduct business, and to maintain and strengthen relationships and bonds with clients.

Taxpayer has provided the Department with a calendar of its events, pictures, and testimonial letters regarding these activities. Taxpayer states that "the horses are utilized significantly throughout the year to promote the Corporation." (Letter dated May 29, 2008). More specifically, Taxpayer states that it "hosts between twelve (12) and eighteen (18) major seminars and outings," for which the use of the horse ranch is "central."

(Letter dated October 10, 2007). By way of description, Taxpayer characterizes the events thusly:

[T]he Corporation holds an extremely large event with the horses in June each year which draws close to one thousand clients, their family members and friends and holds another large event with the horses in July that draws a couple hundred clients and potential clients all from key positions in the aviation industry.

(Taxpayer's Letter dated May 29, 2008)

However, invitations to the June events (during 2003, 2004, and 2005), samples of which Taxpayer has provided to the Department, promote golf as the central focus and do not mention horses at all. The invitations are clearly marked as relating to a "Golf Outing," following which guests are invited back to "the ranch for cocktails, dinner and late night [port] with cigars." Nowhere on the invitations are horses mentioned.

Invitations to the July events (during 2003, 2004, and 2005), samples of which Taxpayer has provided to the Department, promote a "Family Fun Day." The 2003 event invitation mentions fireworks and a swimming pool. Horses are not mentioned on the invitation. The 2004 event invitation mentions fireworks, a swimming pool, and "parent/child races, relays, watermelon eating contest, water balloon toss, ring toss, duck pond, tug of war, balloon animals, and much more with prizes for all who participate," but nothing about horses. The 2005 event mentions "horseback riding" after a series of other items, including fireworks, a swimming pool, "parent/child races, relays, watermelon eating contest, water balloon toss, ring toss, duck pond, tug of war, [and] balloon animals...."

Taxpayer's calendar of events includes the years 2003, 2004, and 2005 respectively. IN reviewing the calendars of events provided by Taxpayer, this Letter notes that:

In 2003, Taxpayer participated in five separate events, three of which primarily took place at Taxpayer's horse ranch. The events occupied part or all of 11 days.

In 2004, Taxpayer participated in five separate events, one of which primarily took place at Taxpayer's horse ranch. The events occupied part or all of 10 days.

In 2005, Taxpayer participated in nine separate events, seven of which primarily took place at Taxpayer's horse ranch. The events occupied part or all of 21 days.

As testimonial evidence regarding the impact of such events, Taxpayer has provided the Department with numerous pictures and letters relating to the events. The letters and pictures appear to show social events that occurred in the setting where horses were present. The letters indicate an appreciation of the horses by some of Taxpayer's guests. A handful of testimonial letters are on the letterhead of aviation related businesses. However, very few of the letters are dated. Of the letters that are dated, some contain dates that place them during the time when Taxpayer admits it originally operated the horse ranch for profit (under the name of a subsequently dissolved corporation).

As such, neither the pictures nor the letters provide the sort of documentary evidence that substantiates any purpose for these gatherings beyond entertaining friends and clients. Moreover, based on Taxpayer's own calendars, it appears the horses were only used by Taxpayer in conjunction with promotions on 42 out of 1,096 days.

Lastly, having discussed Taxpayer's claims of reasonableness of expenses and the occurrence of specific activities above, Taxpayer also points to its intent in acquiring and using the horse ranch for promotion and advertising in support of its protest. Taxpayer admits it obtained its first horse "as an investment for breeding." (Taxpayer's letter dated June 17, 2008). As part of its investment, Taxpayer formed a corporation "for the purpose of raising, training, breeding, showing and selling... horses." (Taxpayer's letter dated June 17, 2008). While Taxpayer's original corporation was subsequently dissolved, the horses in question apparently were never relocated. Taxpayer advises that the horses were "given" to Taxpayer by the now-defunct corporation. Taxpayer claims the intent behind the gift of the horses was that the horses could serve in an advertising and promotional capacity for Taxpayer's aviation reclamation business. Taxpayer states that it acquired the horses for advertising and promotion from its now defunct prior corporation because "the horses had been such a big hit with the Corporation's customers." (Taxpayer's letter dated June 17, 2008). As part of its protest, Taxpayer argues that "there is no evidence that the horses were kept for the personal pleasure of the [Taxpayer]," and "the [Taxpayer] does not generally participate with the horses unless visitors are present." (Taxpayer's letter dated May 29, 2008). Taxpayer further advises "that [Taxpayer's] family rarely rides or has any involvement whatsoever with the horses." (Taxpayer's letter dated June 17, 2008).

As part of its argument based on intent, Taxpayer relies on *Rodgers Dairy v. Comm'r*, 14 T.C. 66 (1950). In *Rodgers*, the court sustained a corporation's advertising expenses related to the ownership and use of show horses and dogs. The court found "that the horses were acquired for advertising purposes and also that they were used for that purpose." Taxpayer concludes:

It seems clear from [*Rodgers*, *Bower*, and *Gill*] that so long as a taxpayer actually intends to promote its business and takes steps to do so, a court will allow deductions for expenses incurred in connection therewith despite the fact that the method of advertising may be unconventional or may involve elements of what one would normally consider personal pleasure.

However, as part of its findings, the court in *Rodgers* noted that there was "no direct showing that [the taxpayer] had as a hobby the ownership and exhibiting of dogs and horses." While such a holding would not be

dispositive of the issue (see *Gill*), it would factor into a consideration of a taxpayer's primary purpose or intent in incurring expenses.

In this case, the ranch's Web site indicates that it currently owns 11 horses, nine of which are listed as "sold" or for sale. Nowhere on the Web site is the name of Taxpayer's aviation reclamation business mentioned. There is an entry for one horse indicating that it is Taxpayer's "\$1,000,000 stud," and an entry for another horse indicating that it has received multiple awards in show. Taxpayer's Web site further indicates that Taxpayer's breeding and training regimen produces:

[A] horse that you can bring into your home as we do, down the road or street as we do, share with friends and family of all ages and experience either on the ground or in the saddle as we do. Hang together, lie together, sit together, swim together (hopefully only when you want to) as we do.

(*Emphasis added*).

When viewed as a whole, Taxpayer has failed to provide the Department with enough information to make a determination that the operation of the horse ranch qualifies as an ordinary and necessary business expenditure. Taxpayer has failed to provide the Department with enough information to make a determination that the intent of Taxpayer was to acquire and use the horse ranch as advertising, nor does the Department have enough information to make a determination that the expenses associated with the horse ranch were reasonable in relation to the expected benefits. Lastly, and most importantly, the specific activities Taxpayer cites either do not appear to promote Taxpayer's business or are at best incidental to other events—such as the golf outing. Therefore, at best, the Department is left with contradictory evidence of Taxpayer's intent regarding use of the ranch for advertising and/or promotional reasons.

Taxpayer, in the alternative, argues that if the Department concludes that the horse ranch is a separate business entity, "then all of the expenses are clearly deductible. . . ." (Taxpayer's Letter dated May 29, 2008). To qualify as allowable deductions from business income, Taxpayer must show, *inter alia*, that the horse ranch is an activity engaged in for profit. 26 USCS § 183. To meet a rebuttable presumption of activity engaged in for profit, Taxpayer must show that "the gross income derived from [the] activity for 2 or more of the taxable years in the period of 7 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity...." 26 USCS § 183(d). However, Taxpayer has made no such election and has not provided the Department with sufficient information for the Department to determine that the horse ranch was operated as an activity engaged in for profit.

Taxpayer has not sustained its burden of proof that expenses relating to the ranch are deductible as advertising or other expenses.

#### FINDING

Taxpayer's protest under subsection A is sustained in part and denied in part, and Taxpayer's protest under subsection B is respectfully denied.

#### II. Tax Administration—Negligence Penalty.

#### DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation [45 IAC 15-11-2](#)(b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2](#)(c) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer has not affirmatively established that its failure to pay the proper amount of tax was due to reasonable cause.

#### FINDING

Taxpayer's protest of the imposition of the negligence penalty is respectfully denied.

#### CONCLUSION

I. A. Of the items listed in the Department's Investigation Summary (Control No. 306940-00):

1. Items 4, 5, 6, 7, and 8 (listed on page 9) were previously agreed to by the Department;
2. the luxury vehicles (listed on pages 7 and 8) were previously agreed to by the Department;
3. Items 9, 10, and 11 are allowed;
4. Items 1, 2, and 3 are denied.

- B. The horse ranch expenses are denied.
- II. The protest of the negligence penalty is denied.

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